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STATE PLEASE PASS TO USTR KATE DUCKWORTH
STATE PLEASE PASS TO FEDERAL RESERVE TOM CONNORS
TREASURY FOR SSENICH
COMMERCE FOR KMANN

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SUBJECT: GOC LAUNCHES NEW INITIATIVE TO STIMULATE CREDIT

REF: A) SANTIAGO 23 B) SANTIAGO 75

¶1. SUMMARY: On March 29, the GOC announced a new "Pro-Credit Initiative" designed to stimulate bank and non-bank credit by generating an extra US\$3.6 billion in private loans. The Initiative comes in the face of worsening unemployment and industrial output and places an emphasis on increasing competition in the financial markets as a mechanism for improving access to capital for small-/medium-sized enterprises and individuals. The plan is comprised of many new measures aimed at creating more options for those who need access to financing, spurring risk-averse financial institutions to increase lending to those hit hardest by the financial crisis, and providing support for micro-business initiatives. Some experts have applauded the new measures while others are concerned about the timing of its implementation. END SUMMARY.

ECONOMIC NUMBERS SHOW NO SIGNS OF IMPROVEMENT

¶2. The GOC launched a \$4 billion economic stimulus package in January to cope with the international economic crisis (refs). However, most macroeconomic indicators have yet to show improvement or signs that the effects of the crisis in the Chilean economy have been contained. The stimulus package was designed to create 100,000 jobs and maintain an economic growth rate of 2-3 percent. Recently released data shows an increase in unemployment and a steady contraction of industrial production.

¶3. The unemployment rate rose to 8.5 percent during the December-February 2009 trimester, slightly above market estimates and during a traditionally robust employment season. Industrial activity has declined by 10 percent during the first two months of the year. According to the Federation of Chilean Industry (SOFOPA), industrial production registered a drop of 9.6 percent during February 2009, while physical sales fell by 8.8 percent. The production of consumer goods fell by 5 percent.

GOC RESPONDS WITH NEW MEASURES TO ENSURE CREDIT

¶4. In light of this recent data confirming a stronger than expected economic contraction, the GOC announced a new supplemental package of measures on March 29. This "Pro-Credit Initiative" is designed to stimulate bank and non-bank credit to generate an extra US\$3.6 billion in private loans. The measures will be aimed primarily at boosting access to credit for small-/medium-sized enterprises (SMEs) as well as individuals, who have been hit hardest by the financial crisis.

15. Many economic analysts in Chile have noted that while larger companies have maintained access to capital, SMEs and individuals have had a much harder time doing so. Minister of Finance Andres Velasco has said: "We are placing the emphasis on competition as a mechanism for getting the funds to those who need them." He also believes the Pro-Credit Initiative will create the conditions necessary for Chile to become a platform for exporting financial services.

PROMOTING COMPETITION IN THE FINANCIAL SECTOR

16. The Initiative, comprised of many new measures, seeks to improve access to capital for those who have had difficulty maintaining liquidity, rolling over debt, or taking out new loans because of the financial crisis. The hoped-for result will be stimulated production, demand, and employment. The Initiative will create more options for access to financing for companies as well as individuals, promote greater competition in the financial system to improve access to capital, and provide support for SMEs and micro-businesses. Measures are structured under three main pillars:

-- Measures to Support Micro-Business Activities:

- 1) Increase resources to fund seed-capital;
- 2) Increase subsidies to cover operational costs of financial institutions that provide credit to micro-enterprises;
- 3) Extend up to 3 years the period for renegotiation of payment of tax liabilities.

-- Measures to Facilitate Banking Credit:

- 4) Increase the percent of a home's value covered under the state housing subsidy program;
- 5) Strengthen current CORFO (Chile's Development Promotion Agency) programs that provide state guarantees for small companies that need access to credit or need to renegotiate outstanding loans;
- 6) Increase coverage and availability of funds for working capital for SMEs and micro-enterprises.

-- Measures to Facilitate Non-Banking Credit:

- 7) Increase loan capacities for insurance companies, by allowing them to lend a larger proportion of their capital base;
- 8) Facilitate the use of endorsable mortgages for housing purchases (Note: Endorsable mortgages provide more direct credit to borrowers, are often sold on secondary markets, and can be securitized. End note.);
- 9) Promote securitization of loans to small size companies;
- 10) Promote tax adjustments to increase liquidity and the demand for public tender bonds to finance companies.

REACTIONS: SOME EXPERTS APPLAUD, SOME WORRY

17. Experts stress that one positive consequence of the crisis is it has now motivated the authorities to take microeconomic measures that would otherwise have been postponed. Jose Ramon Valente, a noted economist with the opposition Alianza coalition (center-right), is more concerned about timely implementation of the measures than the Initiative itself. He has said these measures arrive "ten years too late." Guillermo Tagle, a noted economist with the Christian Democrat party (part of the ruling center-left Concertacion coalition), feels the most notable aspect of this announcement is that it shows a permanent and proactive effort to mitigate the consequences of the economic crisis in Chile.

18. COMMENT: Post believes one of the most interesting effects of the Pro-Credit Initiative could be an increase in the number and types of participants in the credit market, which could reduce the cost of capital in the longer term. However, it is unlikely that Chilean banks will now take greater risks in lending practices. Chile's financial regulatory framework will remain unchanged and domestic banks will continue to be risk-averse (because of past history during Chile's financial crisis in the 1980's). In addition, the loans which the GOC hopes to encourage will be guaranteed by the state.

SIMONS